Monthly Economic Update (MEU)

November 2024

Economic Intelligence Unit
The Ceylon Chamber of Commerce

Highlights

Sri Lankan Economy

IMF Reaches Staff-Level Agreement on the Third Review

Sri Lanka has reached a staff-level agreement with the IMF on the third review of its Extended Fund Facility (EFF), pending approval from the Executive Board based on the 2025 national budget and progress in debt restructuring. The agreement unlocks USD 333 mn, boosting total disbursements to USD 1.3 bn. Key priorities include maintaining stability, advancing debt restructuring, enhancing social safety nets, and governance reforms to ensure transparency and confidence. The new government's commitment to reforms presents an opportunity to stabilize the economy and foster sustainable, inclusive growth.

The CBSL Introduces the Overnight Policy Rate and Further eases its Monetary Policy Stance

With effect from 27 November 2024, the Central Bank of Sri Lanka (CBSL) has transitioned to a single policy interest rate mechanism, with the Overnight Policy Rate (OPR) set at 8.00% as the primary monetary policy tool. This shift simplifies policy communication and enhances monetary policy transmission, while the SDFR and SLFR, linked to the OPR. The Monetary Policy Board eased the stance by reducing the effective policy rate by 50 basis points, aiming to guide inflation toward the 5% target while supporting economic recovery.

Inflation: Negative Now, Gradual Recovery by Mid-2025

Headline inflation remained negative in October 2024, driven by downward revision to electricity tariffs and domestic fuel prices, and the softening of volatile food prices, amidst subdued demand pressures. As per the CBSL projections, headline inflation will remain negative in the forthcoming months, deeper than previously projected. However, it is expected to turn positive from mid-2025 and gradually converge towards the targeted level of 5% over the medium term supported by appropriate policy adjustments. Core inflation is expected to slow further over next few months.

Market Interest Rates are largely Stabilized

Market interest rates have stabilized following the accommodative monetary policy stance, fostering notable growth in private sector credit by Licensed Commercial Banks since May 2024.

Sectoral data for Q3-2024 shows broad-based credit expansion across major economic sectors, with momentum expected to continue due to favorable lending rates, economic recovery, and improved sentiments. Yields on government securities have eased, supported by improved fiscal performance, stable economic conditions, and a benign inflation outlook.

Trade Deficit Widens, But Tourism and Remittances Boost External Account

A rise in import expenditure outpacing export earnings widened Sri Lanka's trade deficit in the first nine months of 2024 compared to 2023. However, increased tourism earnings and workers' remittances supported the external current account. The Sri Lankan rupee appreciated by 11% year-to-date against the US dollar, while Gross Official Reserves reached USD 6.5 billion by October 2024, bolstered by foreign exchange purchases and multilateral inflows.

Global Economy

Impact of Proposed U.S. Trade Tariffs on Sri Lanka's Export Sector

The U.S. trade policy under President Trump proposed significant tariff hikes, which could impact Sri Lanka's export sector. This includes a 20% tariff on all foreign goods and an additional 10% tariff on Chinese imports. Sri Lanka's exports to the U.S. were valued at USD 2.76 billion in 2023, and the proposed tariffs could lead to losses, especially in sectors like apparel, rubber, and chemicals, with a potential revenue decline of USD 187.9 million in the apparel sector alone. While Sri Lanka benefits from GSP+ access to the U.S., the tariff increases pose considerable challenges. To address these impacts, Sri Lanka should focus on diversifying export markets, particularly in Asian countries, enhancing domestic competitiveness, and exploring production subsidies for exporters.

Vizhinjam Seaport: A New Competitor in South Asia's Maritime Trade

The Vizhinjam International Seaport in Kerala, India, offers a strategic location, advanced technology, and the ability to handle large vessels, challenging Colombo Port's dominance in the region. As India's first deep-water and semi-automated port, it provides cost-effective transshipment options, boosting India's role in global trade.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

4.7% in Q2-2024

-3% (Q2-2023)

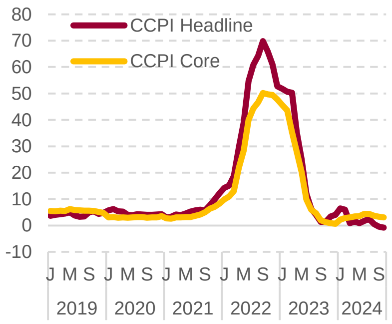
Movement of Purchasing Managers' Index-Oct 2024

Manufacturing PMI	58.1
Services PMI	60.3
Construction PMI (Sep)	48.6

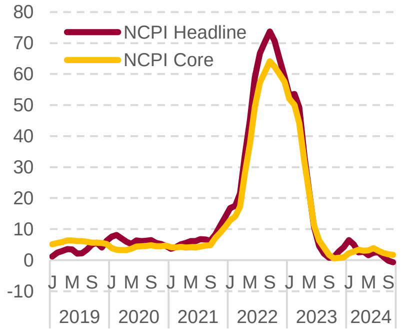
Manufacturing and Services indices recorded an expansion, while Construction index recorded a contraction

Inflation

CCPI Inflation (%)-*Base 2021*



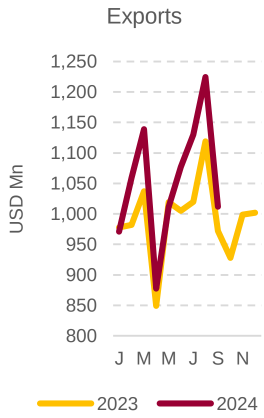
NCPI Inflation (%)-*Base 2021*

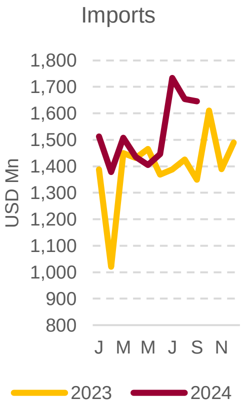


	CCPI Headline	CCPI Core		NCPI Headline	NCPI Core
Oct 2024	-0.8%	3.0%	Oct 2024	-0.7%	1.7%

External Sector

Merchandise Trade





Trade Deficit
Sep 2024
68% ↑

Services Account Balance
Sep 2024
-49.5% ↑

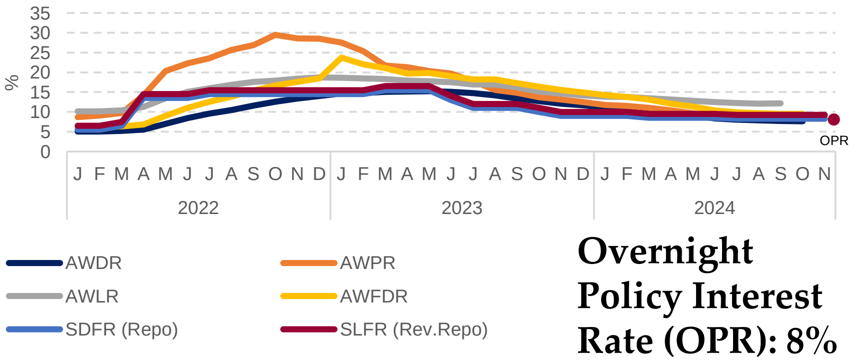
Tourism
Oct 2024

Arrivals ↑
24%

Earnings ↑
35%

Workers' Remittances
Oct 2024 14% ↑

Interest Rates



Overnight Policy Interest Rate (OPR): 8%

Growth in Credit to Private Sector

Sep 2024

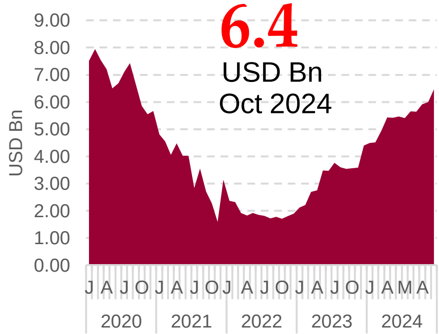
8.9%

Exchange Rate

Appreciation of LKR thus far 2024

11%

Official Reserves



6.4
USD Bn
Oct 2024

KEY INSIGHTS

Sri Lankan Economy

IMF Reaches Staff-Level Agreement on the Third Review

Sri Lanka has reached a staff-level agreement with the IMF on the third review of its four-year Extended Fund Facility (EFF) program. The agreement awaits IMF management and Executive Board approval, contingent upon two key conditions: submission of a 2025 budget aligned with program goals and progress in debt restructuring, ensuring confidence in timely resolution.

Upon approval, Sri Lanka will gain access to USD 333 million, bringing total disbursements to USD 1.3 billion. Encouragingly, the reform agenda has delivered notable outcomes. The economy expanded by 4% year-on-year through June 2024, with strong sectoral growth, while inflation remains contained. Gross official reserves reached USD 6.4 billion by October 2024, reflecting effective foreign exchange management. Fiscal reforms have strengthened public finances, though challenges persist in meeting social spending targets.

The new government has reinforced confidence in policy continuity, which is essential for sustaining reform momentum. Key priorities include maintaining macroeconomic stability, restoring debt sustainability, and ensuring inclusive growth. Continued revenue mobilization, stricter tax compliance, and avoiding new tax exemptions are critical to fiscal health. Additionally, improving the coverage and targeting of social safety nets, particularly the Aswesuma program, is vital to protect vulnerable communities. Governance reforms are equally vital to address corruption risks, enhance transparency, and rebuild economic confidence. The new government's mandate provides an opportunity to deepen these reforms, ensuring robust, inclusive growth. Strengthening institutions and adhering to program objectives will not only stabilize the economy but also lay the foundation for sustainable prosperity.

Debt restructuring remains a pivotal task, with Sri Lanka's recent agreement in principle with bondholders marking significant progress. Finalizing commercial and bilateral debt agreements will be crucial to restoring sustainability. Furthermore, ongoing governance reforms aim to address corruption risks, rebuild confidence, and foster inclusive growth.

INTERNATIONAL MONETARY FUND

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IMF Reaches Staff-Level Agreement on the Third Review under Sri Lanka's Extended Fund Facility Arrangement

November 22, 2024

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End-of-Mission press releases include statements of IMF staff teams that convey preliminary findings after a visit to a country. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF's Executive Board for discussion and decision.

- IMF staff and the Sri Lankan authorities have reached staff-level agreement on economic policies to conclude the third review of Sri Lanka's economic reform program supported by the IMF's Extended Fund Facility (EFF). Once the review is approved by IMF Management and completed by the IMF Executive Board, Sri Lanka will have access to about US$333 million in financing.
- The new government's commitment to the program objectives has enhanced confidence and ensures policy continuity. Sustaining the reform momentum is critical to safeguarding the hard-won gains under the program thus far and putting the economy on a path towards durable recovery and stable and inclusive growth.
- The IMF's Executive Board will consider completion of the review based on (i) the implementation by the authorities of prior actions; and (ii) the completion of financing assurances review, confirming multilateral partners' financing contributions and assessing adequate progress with debt restructuring.

Colombo, Sri Lanka - November 23, 2024: An International Monetary Fund (MF) team led by Peter Breuer, Senior Mission Chief for Sri Lanka, visited Colombo from November 17 to 23, 2024. After constructive discussions in Colombo, Mr. Breuer and Deputy Mission Chief Ms. Katsiaryna Svirydzenka issued the following statement:

"We are pleased to announce that the IMF team reached staff-level agreement with the Sri Lankan authorities on the third review under the 4-year Extended Fund Facility (EFF) arrangement. The arrangement was approved by the IMF Executive Board for a total amount of SDR 2.3 billion (about US$3 billion) on March 20, 2023.

Data Source: IMF

KEY INSIGHTS
Sri Lankan Economy

The CBSL Introduces the Overnight Policy Rate and Further eases its Monetary Policy Stance

With effect from Wednesday, 27 November 2024, the Central Bank of Sri Lanka (CBSL) moved to a single policy interest rate mechanism from its dual policy interest rate mechanism. Accordingly, the Overnight Policy Rate (OPR), set at 8.00 per cent, will serve as the primary monetary policy tool of the CBSL to signal and operationalise its monetary policy stance henceforth.

This system aim to simplify policy communication and enhance the efficiency of monetary policy transmission. Moreover, with this transition to the single policy interest rate mechanism, the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) will no longer be considered policy interest rates of the Central Bank. SDFR and SLFR, the rates applicable for standing facilities that will continue to be available for participatory institutions for overnight transactions with the CBSL, are linked to the OPR with a margin of ± 50 basis points. Accordingly, SDFR and SLFR will be 7.50 per cent and 8.50 per cent, respectively.

Accordingly, the Monetary Policy Board (MPB) of the CBSL, decided to further ease the monetary policy stance and set the newly introduced OPR at 8.00%. With this change, the effective reduction in the policy interest rate would be around 50 basis points from the current level of the Average Weighted Call Money Rate (AWCMR), which continues to serve as the operating target of the Flexible Inflation Targeting (FIT) framework.

As per the MPB of the CBSL, this decision to ease the monetary policy stance was taken following a comprehensive assessment of current and expected domestic and international economic developments, including risks and uncertainties, to ensure that inflation treads towards the inflation target of 5%, while supporting the economy to reach its full capacity.

~~SDFR: 8.25%~~
~~SLFR: 9.25%~~ → **Overnight Policy Rate (OPR): 8%**

A Few other Countries in the World using Single Policy Rate

USA
Canada
New Zealand
Australia

Data Source: CBSL

KEY INSIGHTS
Global Economy

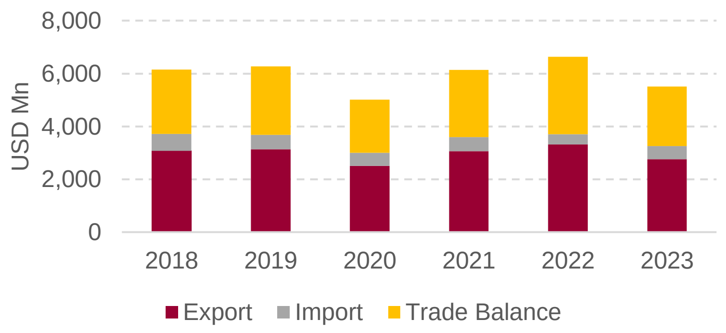
Understanding US's New Trade Policy

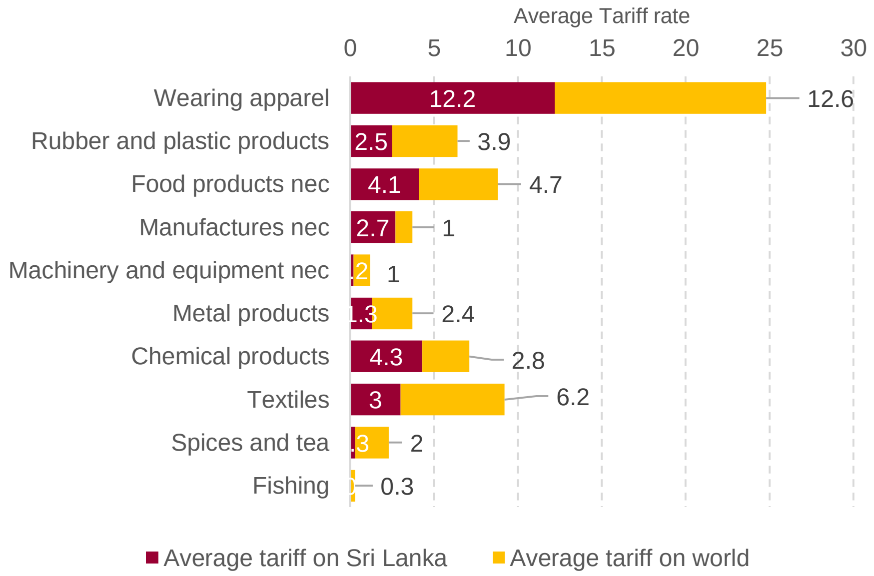
The initial proposed U.S. trade policy under President Trump signals a continuation of protectionist measures, including significant tariff increases. Among these are plans to impose a 20% tariff on all foreign goods and an extra 10% tariff on Chinese imports, tariffs on imports from Canada and Mexico were announced to rise by 25%.

The U.S. has long been Sri Lanka's top export destination. Total exports from Sri Lanka to the U.S. were USD 2,758.57 million in 2023, while imports from the U.S. amounted to USD 507.40 million. However, exports decreased by 16.91% in 2023 compared to 2022, while imports increased by 28.87% in 2023 compared to 2022. The top export product was men's and women's undergarments, totaling USD 598.31 million in 2023, while animal feed was the top import product at USD 107.17 million in 2023. Sri Lanka only has preferential access to the U.S. through GSP+, and although Sri Lanka has steadily grown its exports to the U.S., the proposed tariff hikes could present significant challenges.

According to a study conducted by IPS, an additional 20% tariff could lead to a contraction of USD 187.9 million in revenue for the apparel sector alone, representing an 8.1% decline compared to 2022. Other exports, including rubber, plastics, and chemical products such as essential oils and activated carbon, may also face severe repercussions, with up to 90% of export losses in these sectors anticipated if higher tariffs are implemented. Regarding the proposed tariff rate for China, the broader implications of a potential U.S.- China trade war, with tariffs on Chinese imports rising to as high as 60% or more, may not translate into significant benefits for Sri Lanka. While trade diversion might create temporary opportunities, elevated global import prices and reduced U.S. demand could offset these gains, further complicating Sri Lanka's export outlook.

To address these issues, Sri Lanka's government must adopt a strategic approach to safeguard its export sector, especially U.S. exports, as they constitute a significant proportion of Sri Lanka's total exports. Immediate measures could include offering production subsidies to exporters, easing import tariffs on essential raw materials, and building domestic competitiveness. Diversifying export markets is also important to reduce reliance on traditional partners like the U.S. and the EU. Sri Lanka can find opportunities in Asia as trade in the region is growing rapidly, with a positive outlook for 2025.





Data Source: IPS Calculations using WITS data

Evolving Landscape

With the aim of keeping our members updated on latest global trends, especially those influencing Sri Lanka, ‘Evolving Landscape’ section was added to the MEU. This section guide our members in strategic planning, innovation and competitiveness and helping them identify sector-specific opportunities and challenges.

Vizhinjam Port: Redefining Transshipment in the Indian Ocean

South Asia, with its rich history of bustling trade hubs and historic ports, has long been a cornerstone of global commerce. Positioned strategically, these ports, supported by ongoing infrastructural advancements, have cemented their status on the global trade map, making the region an integral player in international maritime activities. Amidst this competitive landscape, the Vizhinjam International Seaport in Kerala, India, has emerged as a game-changer. As India’s first deep-water container transshipment port and South Asia’s first semi-automated port, Vizhinjam brings unique technological and geographic advantages. Developed by Adani Vizhinjam Port Pvt. Ltd. (AVPPL) under a public-private partnership with the Kerala government, the port aligns with the government’s Maritime India Vision 2030, positioning India strategically in global maritime trade.

Located just 10 nautical miles from major international shipping routes, Vizhinjam Port is designed to handle 1 million twenty-foot equivalent units (TEUs) annually in its first phase and upon completion in 2029, the port will have a capacity of 7.3 million TEUs (twenty-foot equivalent units) across four phases. With a natural depth of 20–24 meters, Vizhinjam requires minimal dredging, accommodating large vessels efficiently which addresses a critical limitation Indian port previously faced—the inability to handle deep-draft ships. As a result, many large container vessels bypassed India, diverting trade benefits to regional competitors. Vizhinjam’s strategic location between the Strait of Malacca and the Suez Canal enables it to serve as a transshipment hub, facilitating the movement of cargo not originating in India. This capability is expected to attract major container traffic to Indian shores for the first time, enhancing the country’s role in global sea trade and boosting its maritime economy.

Evolving Landscape cont’d

Vizhinjam challenges Colombo

The Vizhinjam International Seaport in Kerala, India, is poised to reshape the dynamics of transshipment in the Indian Ocean, directly impacting the strategic position of Colombo Port. Colombo has traditionally served as the primary transshipment hub in the region, leveraging its location along the key shipping route connecting the Middle East to East Asia. It acts as a critical node for several global ports, including Chittagong, Yangon, Kolkata, and Chennai, which rely on Colombo for efficient cargo movements. Vizhinjam’s entry into this space challenges Colombo’s dominance by offering competitive advantages such as lower transshipment costs and proximity to India’s southern tip, enabling it to consolidate Indian-origin cargo. The port’s strategic location on a core international shipping lane and its ability to handle large, deep-draft vessels could attract a significant portion of the cargo currently routed through Colombo. As a fully automated and technologically advanced facility, Vizhinjam enhances operational efficiency, making it a viable alternative for mainline vessels seeking faster and more cost-effective solutions.

The Sri Lanka Ports Authority (SLPA) has clarified concerns about the recent decline in transshipment volumes at the Port of Colombo, attributing it to global supply and demand dynamics rather than competition from expanding Indian ports. While regional ports are often seen as rivals, the SLPA highlights the potential for industry collaboration to meet market demands. Temporary cargo declines, influenced by seasonal trends and global economic factors, are a common occurrence affecting ports worldwide, including Colombo. The SLPA views regional port expansions as complementary rather than adversarial to Colombo’s operations.

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